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No. 00-205

In the

Supreme Court of the United States

RUTH E. JOHNSON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

Petitioner,

v.

J.C. PENNEY NATIONAL BANK,

Respondent.

On Petition for Writ of Certiorari to the Court of Appeals of Tennessee

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioner Ruth E. Johnson, Commissioner of Revenue, State of Tennessee, submits this Reply Brief in support of her Petition for Writ of Certiorari.

I.

THE DECISION BELOW IS NOT "FACTBOUND" AND CLEARLY APPLIES A "PHYSICAL PRESENCE" RULE.

Contrary to the claims of Respondent J.C. Penney National Bank ("JCPNB"), the Tennessee Court of Appeals addressed the fundamental constitutional issue before it in comprehensive terms that are not narrowly confined to this case. The Tennessee court's decision does not turn on any idiosyncratic feature of JCPNB's business, but on the holding that its lack of physical presence in Tennessee deprives the State of nexus to tax it under the Commerce Clause. There is nothing particularly remarkable about JCPNB's business, except its studied effort to avoid establishing a physical presence in Tennessee. It would, in fact, be hard to imagine a case in which there were more generic facts than this one,[1] or in which a court used broader constitutional concepts and doctrines to address those facts.

Any reasonable reading of the Tennessee court's decision evidences that its holding is based on its conclusion that JCPNB was not physically present in the State. The Tennessee court begins its analysis by plainly announcing

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[1] The court itself commented that it had reduced the facts "perhaps to the point of oversimplification . . . . " Opinion, Appendix to Petition for Certiorari [hereinafter "App."] at 3a.

its intent to "delineate that level of 'presence' in the State of Tennessee that will justify the imposition of the types of taxes that are subject of this appeal." Opinion, App. at 18a. The Tennessee court recognizes that both *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), and *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992), "are clear in their holding that in the context of a use tax, physical presence is required in order to satisfy the substantial nexus requirement of *Complete Auto*." Opinion, App. at 19a. It then declares that "[t]he only real issue is whether there is any reason to distinguish the present case from *Bellas Hess* and *Quill*." Opinion, App. at 19a.

After recounting the Commissioner's argument that those cases are distinguishable because they involved use taxes instead of franchise and excise taxes, the Tennessee court then concludes: "We must reject the Commissioner's argument. While it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case." Opinion, App. at 19a. The court went on to summarize that "we feel that the outcome of this case is governed by *Bellas Hess* and *Quill*, as those decisions interpret the first prong of the *Complete Auto* test." Opinion, App. at 20a. Having just characterized *Bellas Hess* and *Quill* as clear in holding that physical presence is required to satisfy substantial nexus, the Tennessee court explicitly applied that same standard to the franchise and excise taxes before it in this case. Thus while it may not have set out with the express "purpose of decid[ing] whether 'physical presence' is required under the Commerce Clause," Opinion, App. at 25a, the Tennessee

court's pronouncements throughout the opinion clearly did apply a physical presence test to the taxes addressed in this case.

Furthermore, JCPNB's own statements in its Brief in Opposition to the Petition conflict with its argument in this regard. JCPNB recognizes that the Tennessee court applied well-established Commerce Clause principles as most recently explained in *Quill*, which embodies the physical presence test. Respondent's Brief in Opposition at 1. Further, JCPNB expressly states,

> The question before the Tennessee Court of Appeals was whether the Commerce Clause permits Tennessee to impose its franchise and excise tax on an out-of-state financial institution that conducted business with Tennessee residents exclusively through the U.S. Mail and *that had established no direct or indirect physical presence in Tennessee.*

Id. at 6 (emphasis added). Having admitted this, JCPNB cannot now credibly contend that the Tennessee court did not apply the *Quill* physical presence requirement to this case. Nor can JCPNB pretend that the opinion below is factbound. The Court did not dwell on the ways in which JCPNB exploits the Tennessee marketplace. The only fact in which the Court was interested was that JCPNB had no physical presence in Tennessee. Opinion, App. at 25a.

II.

THE COMMISSIONER IS NOT ADVOCATING A DUE PROCESS "MINIMUM CONTACTS" STANDARD, BUT A TEST THAT APPROPRIATELY EMBODIES THE COMMERCE CLAUSE'S STRUCTURAL CONCERNS ABOUT THE EFFECTS OF STATE REGULATION ON THE NATIONAL ECONOMY.

Contrary to JCPNB's assertion, the Commissioner is not advancing a "minimum contacts" standard such as that applied under due process to determine *in personam* jurisdiction. *See Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985). The standard that the Commissioner advocates is consistent with the "jurisdiction to tax" requirement of earlier decisions that is embodied in the "substantial nexus" prong of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The earlier decisions recognized the States' ability to tax those who exercise "the substantial privilege of carrying on business within the State." *Wisconsin v. J.C.Penney Co.*, 311 U.S. 435 (1940).[2] *Quill* did not obliterate the principles and cases upon

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[2] In the *Wisconsin* case, 311 U.S. at 444-45, the Court observed,

> The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.

which this Court relied in *Complete Auto*.[3] While *Quill* reaffirmed the *Bellas Hess* holding as a special rule for mail-order sellers subject to a use-tax-collection duty, it did not discard the longstanding and more fundamental principles of nexus.

While the Court's earlier jurisdiction-to-tax decisions contained a due process component, *Quill* has clarified the extent of that component consistent with modern "minimum contacts" doctrine. 504 U.S. at 306-08. Those decisions also embodied a Commerce Clause component. As Justice Black noted in *Central Railroad Co. v. Pennsylvania*, 370 U.S. 607, 619 (1962) (Black, J., concurring), the jurisdiction-to-tax doctrine predated the adoption of the fourteenth amendment and did not originate in the Due Process Clause.[4] The jurisdiction-to-tax analysis was

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[3] *See, e.g., General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Memphis Natural Gas Co. v. Stone*, 335 U.S. 80 (1948); *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940), as cited in *Complete Auto*, 430 U.S. at 279 n.8.

[4] In *McLeod v. Dilworth*, 322 U.S. 349 (1944), Justice Rutledge noted that " 'Due process' and 'commerce clause' conceptions are not always sharply separable in dealing with these problems." 322 U.S. at 353 (Rutledge, J., separate opinion). He further observed,

> The old notion that "mere solicitation" is not "doing business" when it is regular, continuous and persistent is fast losing its force. . . . [F]or *every relevant constitutional consideration affecting taxation* of transactions, regular, continuous, persistent solicitation has the same economic, and should have the same legal, consequences as does maintaining an office . . . or maintaining a place of business. . . .

carried forward by *Complete Auto* in its "substantial nexus" prong, and was not repudiated by *Quill*. Under *Complete Auto*, this Court looks to the "practical effect" of the tax to determine if there is "the necessary connection with the taxing state to give 'jurisdiction to tax'. . . . " 430 U.S. at 281. JCPNB argues that principles of State taxing nexus under *Complete Auto* have been reduced, through *Quill*, to a physical presence test for all purposes. This position is demonstrably wrong, however, as shown by this Court's very careful confinement of *Quill*'s physical presence test to sales and use taxes.

In the context of franchise and income-based taxes, the physical presence test does not embody the concerns which this Court in *Quill* characterized as inherent in the Commerce Clause – those "structural concerns about the effects of state regulation on the national economy." *Quill*, 504 U.S. at 312. A physical presence test can arguably be justified in the sales and use tax area because of the weight of settled expectations of mail-order sellers and the unusual burdens of complying with the requirements of 6,000 sales and use tax jurisdictions throughout the country. Neither of these concerns applies to franchise and excise taxes.

In the first place, contrary to JCPNB's repeated assertions, this Court has never imposed a physical presence test on state jurisdiction to tax outside the very limited realm of sales and use taxation. As already noted, the *Quill* opinion in at least five passages stresses the limitation of its physical presence test to sales and use taxes.

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322 U.S. at 354 (Rutledge, J., separate opinion) (emphasis added).

Quill, 504 U.S. at 301, 307, 311, 315. The courts in Tennessee and in other states[5] that have applied the physical presence test outside of its original context have departed from this Court's doctrine and have produced decisions that make little practical, economic, or constitutional sense. Thus the reliance interests that influenced the Court in *Quill*, 504 U.S. at 316-17, are not present here. Contrary to JCPNB's suggestion, the Tennessee court's decision cannot be viewed as a "routine application of this Court's precedents" (Respondent's Brief in Opposition at 6), since there are no precedents of this Court that suggest any such doctrine.

Secondly, JCPNB's attempt to characterize the burden on multistate businesses in complying with franchise and income-based taxes as remotely equivalent to the burden of complying with sales taxes in 6,000 jurisdictions is hollow. Even assuming that it is more difficult to complete a state corporate income tax return than a sales and use tax return, the burden that concerned this Court in *Quill* was that of complying and reporting in 6,000 jurisdictions, generally on a monthly basis. 504 U.S. at 316 n.6. The potential requirement that a business divide its total sales among 6,000 jurisdictions each month and file returns accordingly was pertinent to structural concerns about the national economy. In contrast, it is neither unreasonable nor burdensome for a national business to fill out 48 income tax returns once a year, even if each

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[5] Other state decisions that have improperly applied the physical presence test of *Bellas Hess* and *Quill* to taxes other than sales and use taxes include *Guardian Industries Corp. v. Department of Treasury*, 198 Mich.App. 363, 499 N.W.2d 349 (1993); and *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App. 2000).

such return requires more skill than completing a single sales tax return. The burdens are not remotely comparable, as leading commentators have observed. *See* Petition for Certiorari at 15-16.

Imposing a physical presence test for state franchise and income-based taxes does not properly foster national economic activity. Instead, it unduly restricts the States from playing their proper role in government, and from securing the revenues necessary to perform their sovereign functions, which include maintaining the infrastructure that enables much national economic activity to occur. The main result of imposing a physical presence test is to make State taxing authority hopelessly antiquated and incapable of adapting to today's business environment, in which physical presence in a State is largely irrelevant to the nature and quantity of business conducted there. This Court has previously let stand a decision of the South Carolina Supreme Court that upheld the application of that State's income tax and business license fees to royalty income of a corporation having no physical presence in South Carolina. *Geoffrey, Inc. v. South Carolina Tax Commission*, 313 S.C. 15, 437 S.E.2d 13, *cert. denied*, 510 U.S. 992 (1993).[6] It is appropriate for this Court to grant plenary review of the decision of the Tennessee court below that is in direct conflict with *Geoffrey* and numerous other decisions in other states, as noted in the Petition for Certiorari and the *amicus curiae*

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[6] JCPNB's effort to recharacterize *Geoffrey* as recognizing an "intangible" physical presence rule is inconsistent with the whole thrust of the South Carolina court. That court did not try to "force-fit" the case into the *Quill* standard; rather it found *Bellas Hess* and *Quill* inapplicable because they are limited to sales and use taxes. 437 S.E.2d at 18 n.4 & accompanying text.

brief filed in this case by New Jersey on behalf of eighteen states. The specific standards for state taxing nexus obviously are not "well-settled," despite JCPNB's assertions to the contrary. Respondent's Brief in Opposition at 16. As the plethora of administrative and judicial proceedings around the country demonstrates, the area is not settled at all, and it will remain a quagmire of uncertainty and conflict until this Court addresses it authoritatively. This case offers an ideal vehicle for the Court to do so.

III.

THIS COURT OUGHT NOT LEAVE THIS TOPIC IN A QUAGMIRE IN ANTICIPATION OF UNCERTAIN ACTION BY CONGRESS.

In *Quill*, this Court indicated that the topic of that decision was an appropriate one for Congressional consideration. 504 U.S. at 318-19. This Court nevertheless granted Quill's application for certiorari and clarified the topic in the absence of action by Congress. The Court should take a similar approach in this case. In fact, action here is more urgent than it was in *Quill*, because this Court has pronounced no clear and specific Commerce Clause standard for State franchise and income-based taxes, while there was clear precedent for guidance in *Quill* as to sales and use taxes. In the absence of action by Congress, which is extremely uncertain, the courts must develop some principles to govern this topic. The various State courts are presently in great disarray, and the current disagreements in their pronouncements will continue until this Court speaks. That Congress might specify statutory criteria at some uncertain future date does not relieve this Court of the duty of establishing a rule of constitutional law to resolve the conflicts and confusion

on the topic, until Congress does act. In fact, Congress would no doubt be aided in its action by a clear pronouncement from this Court as to how its general Commerce Clause principles apply to State franchise and income-based taxes.

CONCLUSION

For these reasons, in addition to those stated in the Commissioner's original Petition and in the *amicus curiae* briefs filed in this case by New Jersey on behalf of eighteen states and by the Multistate Tax Commission, a Writ of Certiorari should issue to review the judgment of the Tennessee Court of Appeals.

Respectfully submitted,

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